

Message Text

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ORIGIN SS-25

INFO OCT-01 ISO-00 SSO-00 /026 R

DRAFTED BY ARA/AND:CFULLER
APPROVED BY ARA:JBUSHNELL
ARA/AND:MBARN"BEY
ARA/ECP:KWIEDEMANN
ARA/RRP:CFINAN
PM:RTITUS
EUR/GE:NLAUDERDALE
EP/IFD:WMILAM
TREASURY:FMARESCA
S/S-LRFLEISCHER

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FM SECSTATE WASHDC
TO AMEMBASSY LIMA IMMEDIATE
INFO AMEMBASSY BONN

S E C R E T STATE 092362

EXDIS FOR AMBASSADOR

E.O. 11652: GDS

TAGS: MASS, EFIN, EAID, PE, GW

SUBJT:PURCHASE WEST GERMAN SUBMARINES AND
PERU'S FINANCIAL CRISIS

REFS: (A) LIMA 2753, (B) STATE 74,45, (C) LIMA 2943,

1. DEPARTMENT APPRECIATES YOUR REPORT (REF A) ON
CONVERSATION WITH ADMIRAL PARODI ABOUT PURCHASE
OF WEST GERMAN SUBMARINES, COSTING SOME \$.5
MILLION. WE WERE NOT SURPRISED TO LEARN OF
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RESTATEMENT BY PERUVIAN NAVY OF ITS RESOLUTION
TO PROCURE ALL FOUR SUBMARINES ACCORDING TO
ORIGINAL DELIVERY PERIOD. AS YOU NOTE IN REPORT,
HOWEVER, IT IS STILL UNCLEAR WHETHER A FINAL GOP
DECISION HAS BEEN MADE TO ADHERE TO OR CANCEL
PROCUREMENT OR TO REDUCE IT OR STRETCH DELIVERY
FORWARD.

2. WE CONTINUE TO PLACE IMPORTANCE ON CLARIFICATION ON DEFINITIVE GOP INTENTION IN THIS REGARD AND ASK YOU NOW TO APPROACH PRESIDENT MORALES BERMUDEZ.

NEED FOR THIS INFORMATION DOES NOT, OF COURSE, RELATE MERELY TO DECISION ON \$6 MILLION MUNITIONS CONTROL CASE OF TORPEDO FIRE-CONTROL SYSTEMS FOR OLD U.S.-SUPPLIED SUBMARINES (REF B). WHETHER PERU MODIFIES ITS PLANNED ACQUISITION OF NEW SUBMARINES HAS CONSIDERABLY WIDER RAMIFICATIONS.

A. WE CONTINUE TO BE TROUBLED BY PERUVIAN ACQUISITION OF MODERN ARMS, WITH THE INEVITABLE EFFECT OF TRIGGERING CATCH-UP ARMS ACQUISITIONS BY PERU'S NEIGHBORS. WHILE NO VIOLATION OF PERU'S COMMITMENT NOT TO PURCHASE NEW ARMS UNTIL 1980 IS HERE INVOLVED, STILL PERU'S GOING THROUGH WITH THIS PURCHASE OF FOUR SUBMARINES WILL INEVITABLY CAUSE REGIONAL POLITICAL/MILITARY TENSIONS.

B. NOR DOES THIS PURCHASE MAKE SENSE IN TIME OF ECONOMIC CRISIS. BANKS CONCERNED WITH PROPOSED BALANCE-OF-PAYMENTS LOAN OF \$260 MILLION

BY REVELATION OF SUCH A LARGE LINE OF CREDIT TAKEN
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OUT BY PERU, REPAYMENT OF WHICH WOULD COINCIDE WITH REPAYMENT OF BALANCE-OF-PAYMENTS LOAN. PROJECTED GRACE PERIOD ON BOTH WOULD EXPIRE IN 1980. BANKS MIGHT ALSO BE CONCERNED BY THIS SIZEABLE FURTHER ADD-ON TO ALREADY GREAT DEBT SERVICING BURDEN PERU MUST BEAR. AS THE BANKS CAME CLOSE TO DROPPING THE \$370 MILLION BALANCE-OF-PAYMENTS LOAN TO PERU IN 1976 WHEN THEY LEARNED OF PERU'S PURCHASE OF \$250 MILLION WORTH OF SOVIET FIGHTER BOMBERS, SO IN 1978 THE BANKS MIGHT FIND IT DIFFICULT TO CONCLUDE A NEW LOAN AGREEMENT IN THE FACE OF CONTINUED MAJOR ACQUISITIONS OF MILITARY EQUIPMENT BY PERU.

C. AS REF C STATES, PERU EVIDENTLY INTENDS TO SEEK A RESCHEDULING OF OFFICIAL DEBT. AGREEMENT BY OFFICIAL CREDITORS TO PROCEED WITH RESCHEDULING WILL CERTAINLY BE COMPLICATED BY REQUIRED REPAYMENT OF LARGE MILITARY DEBT. THAT COMPONENT OF TOTAL DEBT WOULD NOW BE ENLARGED SIGNIFICANTLY IF THE PURCHASE OF COSTLY NEW SUBMARINES WERE NOT CUT BACK.

D. IN ADDITION, OF COURSE, PERU SEEKS FROM THE U.S., AND MAY NEED, ADDITIONAL FINANCIAL ASSISTANCE THIS YEAR TO COVER POSSIBLE GAPS THAT MIGHT EMERGE IN EXTERNAL PAYMENTS, EVEN IF IN COMPLIANCE WITH IMF STANDBY AND THUS ABLE TO DRAW ON FUND RESOURCES AS WELL AS ON COMMERCIAL BANK ROLLOVER LOAN. WE WILL CONTINUE TO EXAMINE QUESTION OF ADDITIONAL ASSISTANCE IN LIGHT OF EVOLVING ECONOMIC AND FINANCIAL SITUATION IN PERU. HOWEVER, CONSIDERATION OF ANY FORM OF ADDITIONAL ASSISTANCE WOULD PROBABLY BE IMPOSSIBLE WITHOUT A FUNCTIONING IMF PROGRAM. CONTINUING PURCHASES ON CREDIT OF NON-PRODUCTIVE ITEMS SUCH AS SUBMARINES WOULD APPEAR, THUS, TO PREJUDICE SUCH ASSISTANCE.

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3. PERU HAS SOUGHT ASSISTANCE FROM VARIOUS ORGANIZATIONS--THE IMF, THE COMMERCIAL BANKS, AND THE U.S. AND OTHER GOVERNMENTS. AN ESSENTIAL PART OF THE GOP APPROACH TO SOURCES OF POTENTIAL ASSISTANCE HAS BEEN TO ADOPT A SWEEPING AUSTERITY PROGRAM. SUSTAINED PURCHASES ON CREDIT OF

NON-PRODUCTIVE ITEMS AS SUBMARINES PREJUDICES ANY ASSISTANCE FROM OUTSIDE.

4. AMBASSADOR IS REQUESTED TO SEEK AN EARLY APPOINTMENT WITH MORALES BERMUDEZ. WE SUGGEST YOU EXPLAIN OUR INTEREST, AS DISCUSSED ABOVE, IN CLARIFICATION OF GOP PLANS WITH RESPECT TO ITS OVER-ALL SUBMARINE FLEET, POSSIBLY USING YOUR POINT OF DEPARTURE OUR ONGOING EVALUATION OF THE MUNITIONS CONTROL CASE. THEN YOU MIGHT POINT OUT THE WIDER IMPLICATIONS OF THE ACQUISITION OF WEST GERMAN SUBMARINES AT THIS TIME. YOU SHOULD RECOMMEND STRONGLY THAT THE GOP REVIEW ITS ACQUISITION PLAN AND DETERMINE WHETHER IT IS TRULY IN THE BEST INTEREST OF THE COUNTRY TO MAINTAIN THE ORDER FOR THE FOUR SUBMARINES. IN SUM, YOU SHOULD URGE THAT THE GOP CANCEL OR SIGNIFICANTLY CUTBACK THE CONTRACTED PURCHASE.

5. SHOULD MORALES BERMUDEZ AGREE TO MODIFY THE PURCHASE PLAN, YOU MAY INDICATE THAT WE SHALL MAKE EVERY EFFORT TO COME TO AN EARLY FAVORABLE DECISION ON THE MUNITIONS CONTROL CASE. MEANWHILE, WE REMAIN READY TO EXPLORE WITH PERU POSSIBLE MEANS TO HELP ALLEVIATE PERU'S FINANCIAL PROBLEM, IF THIS

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IS WARRANTED AND FEASIBLE, IN THE CONTEXT OF A
WORKING IMF STABILIZATION PROGRAM IN PERU.

6. AMBASSADOR MAY ASSURE MORALES BERMUDEZ THAT HIS
LETTER TO PRESIDENT HAS BEEN RECEIVED, IS UNDER URGENT
CONSIDERATION, AND A REPLY WILL BE SENT SHORTLY. VANCE

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: MILITARY PROCUREMENT, FINANCIAL CRISIS, SUBMARINES, DEBT REPAYMENTS
Control Number: n/a
Copy: SINGLE
Draft Date: 11 apr 1978
Decaption Date: 20 Mar 2014
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978STATE092362
Document Source: CORE
Document Unique ID: 00
Drafter: CFULLER
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780155-0878
Format: TEL
From: STATE
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780469/aaaacguw.tel
Line Count: 181
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 129e61b2-c288-dd11-92da-001cc4696bcc
Office: ORIGIN SS
Original Classification: SECRET
Original Handling Restrictions: EXDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: SECRET
Previous Handling Restrictions: EXDIS
Reference: 78 LIMA 2753, 78 STATE 74, 78 LIMA 2943
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 25 jul 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3004210
Secure: OPEN
Status: NATIVE
Subject: T:PURCHASE WEST GERMAN SUBMARINES AND PERU'S FINANCIAL CRISIS
TAGS: MASS, EFIN, EAID, PE, GE
To: LIMA
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/129e61b2-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014